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IN THE

Supreme Court of the United States

OCTOBER TERM, 1951.

No. 415.

JAMES B. MORRIS,
THE PROTECTIVE COMMITTEE FOR THE HOLDERS OF MISSOURI PACIFIC RAILROAD COMPANY 5¼% SECURED SERIAL GOLD BONDS,
DE LANCEY C. SMITH, AVERY BRUNDAGE, *et al.*
Petitioners,

v.

GROUP OF INSTITUTIONAL INVESTORS,
BONDHOLDERS PROTECTIVE COMMITTEE, NEW ORLEANS, TEXAS & MEXICO RAILWAY COMPANY FIRST MORTGAGE,
EDMUND WRIGHT, *et al.*,
PROTECTIVE COMMITTEE FOR HOLDERS OF GENERAL MORTGAGE BONDS,
MANUFACTURERS TRUST COMPANY, AS TRUSTEE,
BANKERS TRUST COMPANY, AS TRUSTEE,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

LEMUEL SKIDMORE,
CARL H. McCLURE III,
165 Broadway,
New York, N. Y.
Attorneys for Protective Committee.

DE LANCEY C. SMITH,
351 California Street,
San Francisco, California.
Attorney for De Lancey C. Smith, Avery Brundage, et al.

FRED N. OLIVER,
WILLARD P. SCOTT,
110 East 42nd Street,
New York, N. Y.
Attorneys for James B. Morris.

FOREST P. TRALLES,
CARROLL C. GILPIN,
818 Olive Street,
St. Louis, Missouri,
Of Counsel for Petitioners.

Pandick Press, Inc., 22 Thames St., New York 6, N. Y., U. S. A.

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Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioners, JAMES B. MORRIS, THE PROTECTIVE COMMITTEE FOR THE HOLDERS OF MISSOURI PACIFIC RAILROAD COMPANY 5¼% SECURED SERIAL GOLD BONDS, OF WHICH

DE LANCEY C. SMITH IS CHAIRMAN, and DE LANCEY C. SMITH, AVERY BRUNDAGE, *et al.*, respectfully pray for a writ of certiorari to the Court of Appeals for the Eighth Circuit to review a judgment, entered August 14, 1951, affirming a decision of the District Court for the Eastern District of Missouri approving a plan of reorganization for Missouri Pacific Railroad Company and its principal subsidiary, New Orleans, Texas & Mexico Railway Company.

Summary Statement of Matters Involved.

This case involves the reorganization under Section 77 of the Bankruptcy Act of Missouri Pacific Railroad Company (herein called "Missouri Pacific") and its principal subsidiary, New Orleans, Texas & Mexico Railway Company (herein called "New Orleans"), and the question of whether the Interstate Commerce Commission followed legal standards in valuing New Orleans on the basis of physical value rather than on the basis of earning capacity.

Petitioners are the holders, or representatives of holders, of a substantial amount of the outstanding publicly held Missouri Pacific Railroad Company 5¼% Secured Serial Gold Bonds (herein called "Secured Serial bonds") and of the capital stock of New Orleans.* The Secured Serial bonds are collateral obligations of Missouri Pacific, secured by the pledge of approximately 81.9% of the capi-

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* Morris owns $1,060,000 principal amount of Secured Serial bonds; the Protective Committee, comprised of DeLancey C. Smith, Leo J. Sheridan and Paul E. Kling, represents holders of $2,225,000 principal amount of Secured Serial bonds, together representing a total of $3,285,000 principal amount of said bonds or over 31% of the total issue publicly held. DeLancey C. Smith, Avery Brundage and others associated with them, together with Morris, are the owners of 4,650 shares of capital stock of New Orleans, or over 54% of the shares publicly held.

tal stock of New Orleans.* Therefore, the treatment to be accorded to the Secured Serial bondholders in any plan of reorganization is dependent on their rights with respect to the pledged collateral and on the value of that collateral. The latter question is, in turn, dependent upon the value of New Orleans.

Action of the Commission.

The Commission concluded that in a future normal year New Orleans could be expected to earn $4,700,000 available for fixed charges, after payment of federal income taxes (275 I. C. C. at 102). The application of any reasonable earnings test, whether related to past or prospective earnings, would produce a value or capitalization for New Orleans of well over $100,000,000. This was pointed out by the Commission in its Fourth Supplemental Report (275 I. C. C. at 109):

> "The New Orleans' annual average 1937-41 earnings of $2,793,304, average 1942-48 earnings of $6,506,176, average 1937-48 earnings of $4,959,146, and trustee's normal-year forecast (as herein adjusted) of $4,700,000, if capitalized at 4½ percent, produce respectively, $62,073,422, $144,581,688, $110,203,244, and $104,444,444. The average of the 1946-1948 earnings, amounting to $6,774,636, similarly capitalized produce $150,547,467.* * * "

Thus the Commission itself demonstrated that on any reasonable earnings basis, other than the immediate prewar depression years, the resulting valuation of New Orleans is well over $100,000,000.

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* New Orleans stock is outstanding in the amount of 148,329 shares of $100 par value per share. Of this total, 8,598 shares are publicly held, 121,460 shares are owned by Missouri Pacific and pledged by it to secure the Secured Serial bonds, and the remainder, 18,271 shares, are owned by Missouri Pacific, but are not pledged to secure the Secured Serial bonds.

However, the Commission then proceeded to arrive at a value for New Orleans upon an entirely different basis. It concluded that the value for reorganization purposes should have "a reasonable relationship" to the cost of reproduction less depreciation of $82,206,158 (275 I. C. C. at 111 and 213) and limited total value to $83,700,000 (275 I. C. C. at 111-112).

Even in this respect the Commission adopted the lowest of the available figures on physical value. For example, book value for the "total of all assets" was $96,836,047 as of December 31, 1947 (275 I. C. C. at 110).

Following the filing of objections to the valuation method employed in its Fourth Supplemental Report, the Commission issued its Fifth Supplemental Report, in which it adhered to its prior conclusion. It stated (275 I. C. C. at 213):

> "* * * We further stated, as quoted above, that the capitalization should have a reasonable relationship to the physical value of its properties plus the value of investments and other stated additions thereto and to its investment as shown on its balance sheet. In our opinion, a capitalization based solely on earnings without regard to the value of capitalizable assets as measured other than by earnings would not be justified."

Action of the District Court.

When the proceedings came before the District Court for approval of the plan of reorganization certified by the Commission, petitioners duly objected to the use by the Commission of reproduction cost less depreciation as the controlling factor in valuation. That objection was overruled, the District Court holding (R. 926):

> "It is not a violation of the statute to regard reproduction cost less depreciation as a maximum permissible capitalization."

At the hearings before the District Court, petitioners also sought to introduce evidence to prove that Missouri Pacific had charged New Orleans excessive interest, to the extent of $1,369,272, on advances made by the former to the latter. Following exclusion of the evidence, an offer of proof was made by petitioners to the following effect (R. 608-614):

> At the time the advances were made by Missouri Pacific to New Orleans, petitioners' witness was an active officer of the Missouri Pacific and of New Orleans, was in close touch with the making of the advances and personally arranged the details in nearly all of them. Various interest rates were set, depending on what Missouri Pacific was paying for money at the time. The rate of 5½% on all except $400,000 of the advances was based upon the fact that over the period covered by these advances Missouri Pacific had been borrowing money at various rates averaging approximately 5½%. A rate of 6% was set on $400,000 of the advances, because it was secured by the pledge to Missouri Pacific of certain bonds which were, in turn, pledged to the RFC by Missouri Pacific to secure a loan at a 6% rate. The details of the borrowings by Missouri Pacific were shown. In June, 1946, interest rates on the RFC and banking loans to Missouri Pacific were reduced from 6% to 4%, retroactive to April 1, 1933. Had the interest rates charged New Orleans by Missouri Pacific been adjusted to accord with this reduction in the rates effected on Missouri Pacific loans, interest accrued against New Orleans from the beginning of the proceedings to January 1, 1948 (the effective date of the Commission's proposed plan) would have been reduced $1,369,272. At the same time, the trustee of New Orleans, who is also trustee of Missouri Pacific, advanced $2,500,000 for building a new terminal at Houston, Texas, on which New Orleans is being paid only 3½% interest by the principal using Company also

operated by the same trustee, while New Orleans is being charged 5½% and 6% by Missouri Pacific.

Although this offer of proof related to one of petitioners' objections to the plan and related to the reorganization value of New Orleans, the District Court failed to discuss it in its opinion on the plan (R. 915 *et seq.*). However, the District Court did discuss it in another opinion filed concurrently with its opinion on the plan, but dealing with a petition seeking the discharge of the proceedings as to New Orleans. It there held, after referring to the decision by this Court in *Comstock* v. *Group of Institutional Investors*, 335 U. S. 211, that (R. 1036):

> "If the findings in that case do not cover the matter, nevertheless it was an issue which could have been raised at that time, and cannot be raised now."

In so holding, the District Court apparently overlooked the fact that although its decision in the *Comstock* case was rendered December 21, 1945 (see *In Re Missouri Pacific R. Co.*, 64 F. Supp. 64, 77 *et seq.*), the reduction in interest rates paid by Missouri Pacific that are relied upon by petitioners as requiring a corresponding adjustment in rates charged by Missouri Pacific to its subsidiary New Orleans did not occur until the latter part of May and June, 1946.

Action of the Court of Appeals.

The Court of Appeals affirmed the District Court's action in approving the plan. As to the claimed application of improper standards of valuation it adverted to the Commission's reliance upon physical value, but dismissed this with a brief statement to the effect that the Commission did not fail to give full consideration to earning power

(C. R. 28).* As to the question of adjustment of excessive interest rates it merely observed that it found no error (C. R. 34-35).

It is this decision of which review is sought.

Jurisdiction to Review.

The jurisdiction of this Court is invoked under Title 28, United States Code, Judiciary and Judicial Procedure, Section 1254.

Opinions Below.

The opinion of the Court of Appeals is reported in *State of Texas* v. *Group of Institutional Investors*, 191 F. (2d) 265; the opinion of the District Court is reported in *In Re Missouri Pacific R. Co.*, 93 F. Supp. 832; the decisions of the Interstate Commerce Commission are reported in *Missouri Pacific Railroad Company Reorganization*, 275 I. C. C. 59 and 275 I. C. C. 203.

Questions Presented.

1. Whether, in a railroad reorganization under Section 77 of the Bankruptcy Act, reorganization value can be determined by physical value and the earnings value be disregarded because the earnings value substantially exceeds the physical value.

2. Whether the decision of this Court in *Comstock* v. *Group of Institutional Investors*, 335 U. S. 211, on the validity of a claim by Missouri Pacific against New Orleans can be determinative of the fairness of the interest rates charged thereon when the circumstances affecting the question of fairness did not arise until six months after the decision by the District Court in that case and the issue relating thereto was not raised in those proceedings.

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* "C. R." refers to the printed record in a separate pamphlet entitled "Proceedings in United States Court of Appeals, Eighth Circuit".

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

I. The decision below is in conflict with applicable decisions of this Court.

A.

The decision below upholding the valuation methods employed by the commission is in conflict with applicable decisions of this Court.

In *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510, this Court considered the question of the proper method of valuation in a reorganization proceeding. The Court's criticism of the valuation method there employed by the District Court arose from the fact that "little, if any, effort was made to value the whole enterprise by a capitalization of prospective earnings" (at page 525). In setting forth the proper principles to be followed, the Court said (at page 526):

> "As Mr. Justice Holmes said in *Galveston, H. & S. A. Ry. Co.* v. *Texas*, 210 U. S. 217, 226 'the commercial value of property consists in the expectation of income from it.' And see *Cleveland, C. C. & St. L. Ry. Co.* v. *Backus*, 154 U. S. 439, 445. Such criterion is the appropriate one here, since we are dealing with the issue of solvency arising in connection with reorganization plans involving productive properties. It is plain that valuations for other purposes are not relevant to or helpful in a determination of that issue, except as they may indirectly bear on earning capacity. *Temmer* v. *Denver Tramway Co.*, 18 F. 2d 226, 229; *New York Trust Co.* v. *Continental & Commercial Trust & Sav. Bank*, 26 F. 2d 872, 874. The criterion of earning capacity is the essential one if

the enterprise is to be freed from the heavy hand of past errors, miscalculations or disaster, and if the allocation of securities among the various claimants is to be fair and equitable.* * *"

* * * * * *

"A sum of values based on physical factors and assigned to separate units of the property without regard to the earning capacity of the whole enterprise is plainly inadequate."

This decision was rendered without reference to the specific statutory provision of Section 77 of the Bankruptcy Act, which is quite specific. The relevant provision is contained in subdivision (e), which provides in part, as follows:

"If it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts."

The Statute sets forth two directions, *first,* an affirmative one, that due consideration be given to earning power, and, *second,* a negative one, that limited consideration, if any, be given to reproduction cost and related cost bases.

When this provision came before this Court for interpretation, it applied the same rule that had been set forth

in the *Consolidated Rock Products* case. In *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific R. Co.*, 318 U. S. 523, this Court interpreted the foregoing provision of Section 77 as follows (at page 540-541):

> "It is argued that, under this provision, earning power is not the primary criterion of value and that the Commission did not give proper weight to original cost, reproduction cost new, or the valuation for rate making purposes. We disagree."
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> "The basic question in a valuation for reorganization purposes is how much the enterprise in all probability can earn. Earning power was the primary test in former railroad reorganizations under equity receivership proceedings. Temmer *v.* Denver Tramway Co., F. 2d 226, 229; New York Trust Co. *v.* Continental & Commercial Bank, 26 F. 2d 872, 874."
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> • • • • • •
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> "And it is our view that Congress when it passed §77 made earning power the primary criterion. The limited extent to which §77(e) provides that reproduction cost, original cost, and actual investment may be considered indicates that (apart from doubts concerning constitutional power to disregard them) such other valuations were not deemed relevant under §77 any more than under §77B 'except as they may indirectly bear on earning capacity.' Consolidated Rock Products Co. *v.* DuBois, supra, [312 US] p. 526."

This decision makes it plain that under Section 77 the so-called physical values are not relevant to value for reorganization purposes, except as they bear on earning capacity. While it is true that in both the *Consolidated Rock Products* case and the *Milwaukee* case the value sought to

be established contrary to the application of this principle was in excess of the valuation resulting from an appraisal of earning capacity, nevertheless, the opinions of this Court clearly contain no limitation to the effect that the principle is to be applied only where earning value is less than physical value. We submit that the clear purport of these decisions is an unrestricted application of the earnings principle as a basis for determining value in reorganization cases, irrespective of whether physical value exceeds earnings value or is less than earnings value.

At an earlier stage in these proceedings the Commission recognized that reorganization value might be higher than physical, or rate-making value. In its 1944 report (257 I. C. C. 479, 522) it quoted with approval its earlier statement in *Chicago G. W. R. Co. Reorganization*, 247 I. C. C. 193, 195, where it distinguished between economic value for reorganization purposes and physical, or rate-making value. The Commission there said:

> "• • • Because of sparsity of business available or the competition of other carriers, for example, it may not be possible to earn a reasonable return upon 'value for rate-making purposes', even if public regulation allows the carrier a free hand in the making of its rates and charges. In that event the economic value will be the lower of the two. On the other hand it may be the higher, if the carrier is so strategically located it can earn more than a minimum reasonable return upon 'value for rate-making purposes' under public regulation, which must to some extent be based upon general transportation conditions."

Having quoted this earlier statement with approval, the Commission then continued (257 I. C. C. 523):

> "Those criteria have governed us in fixing capitalizations of reorganized railroads and, in our opinion, are not only consistent with the statutory standards, but are also consistent with sound financial practices and the public interest. Our views in this respect have been sustained by many Federal district courts and by the Supreme Court of the United States. * * *"

Here, however, the Commission has accorded the major decisive role to physical value, as such. It has not even remotely suggested that the elements of physical value used by it have the slightest bearing upon the earning power of New Orleans. In fact, its own recitation of fact demonstrates exactly the contrary.

The Commission's failure to give due consideration to earning power and its reliance on physical values results in discrimination, which is emphasized by a comparison of the ratio of prospective earnings to value found for New Orleans and Missouri Pacific. The Commission estimates future normal earnings of $4,700,000 for New Orleans, while fixing a value of $83,700,000, or a ratio of 5.6%. For Missouri Pacific, the Commission estimates future normal earnings of $19,000,000, while fixing a value of $509,700,000, or a ratio of only 3.7%. If the Missouri Pacific ratio of earnings to capitalization of 3.7% adopted by the Commission were applied to the Commission's estimates of New Orleans' future earnings, it would produce a value of over $127,000,000, or more than 50% higher than the value fixed by the Commission for New Orleans (275 I. C. C. at 109-113).

Reliance upon physical values reaches a more incongruous result under the circumstances here present than would ordinarily obtain. Here the primary objective of valuation is to ascertain the value of the stock pledged as

collateral for the Secured Serial bonds. Obviously that stock has value in so far as New Orleans has value as a profitable enterprise and the stock represents a right to control such enterprise and participate in the profits. It is a matter of common knowledge that the customary and accepted method of valuing stock is to put it up for sale. Here the valuation process is intended as a substitution for the normal sale.

Consequently it must be apparent that questions of book value or physical value have no relevancy whatever in valuing the stock pledged as collateral. Physical value of the properties has no more bearing upon the value of the stock than does liquidation or scrap value.

The Court of Appeals explains its position by stating that the Commission made allocations in respect of the New Orleans stock on the basis of the full value of that stock and that the Commission undertook to fully compensate those interested in the stock. (C. R. 28-29).

However, this view of the Court of Appeals overlooks the fundamental fact that what may be reasonable compensation on the basis of an $83,700,000 valuation of New Orleans would be far inadequate if New Orleans were valued at well over $100,000,000. The question of compensation can have meaning only in relation to rights surrendered and a determination of those rights in turn rests upon the underlying values attached to the property in question. Consequently, it must be evident that the mere statement of conclusion by the Court of Appeals cannot be dispositive of the case.

As a consequence of the decision below, it is submitted that physical values have been effectively relied upon in this case to limit the value that would otherwise have resulted from the application of the normal earnings tests,

and that, in consequence, the legal standards employed are in conflict with the principles applied by this Court in the two cases referred to above.

B.

The decision below holding that the decision in the *Comstock* case is determinative of interest charged by Missouri Pacific against New Orleans is in conflict with applicable decisions of this Court.

In *Commissioner* v. *Sunnen*, 333 U. S. 591, this Court in considering the doctrine of *res judicata* stated (at page 597):

> "It is first necessary to understand something of the recognized meaning and scope of *res judicata*, a doctrine judicial in origin. The general rule of *res judicata* applies to repetitious suits involving the same cause of action. It rests upon considerations of economy of judicial time and public policy favoring the establishment of certainty in legal relations. The rule provides that when a court of competent jurisdiction has entered a final judgment on the merits of a cause of action, the parties to the suit and their privies are thereafter bound 'not only as to every matter which was offered and received to sustain or defeat the claim or demand, but as to any other admissible matter which might have been offered for that purpose.' *Cromwell* v. *County of Sac*, 94 U. S. 351, 352."
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> * * * * * *
>
> "But where the second action between the same parties is upon a different cause or demand, the principle of *res judicata* is applied much more narrowly. In this situation, the judgment in the prior action operates as an estoppel, not as to matters which might have been litigated and determined, but 'only as to those matters in issue or points contro-

verted, upon the determination of which the finding or verdict was rendered.' *Cromwell* v. *County of Sac, supra,* 353. And see *Russell* v. *Place,* 94 U. S. 606; *Southern Pacific R. Co.* v. *United States,* 168 U. S. 1, 48; *Mercoid Corp.* v. *Mid-Continent Co.,* 320 U. S. 661, 671."

In *Larsen* v. *Northland Trans. Co.,* 292 U. S. 20, this Court similarly stated (at page 25):

> "The established rule in this Court is that if, in a second action between the same parties, a claim or demand different from the one sued upon in the prior action is presented, then the judgment in the former cause is an estoppel 'only as to those matters in issue or points controverted, upon the determination of which the finding or verdict was rendered.' *Bates* v. *Bodie,* 245 U. S. 520, 526; *United States* v. *Moser,* 266 U. S. 236, 241; *United Shoe Machinery Corp.* v. *United States,* 258 U. S. 451, 458."

In *Ash Sheep Co.* v. *United States,* 252 U. S. 159 this Court stated (at page 170):

> "We agree with the Court of Appeals that 'a judgment is not conclusive on any question which, from the nature of the case or the form of the action, could not have been adjudicated in the case in which it was rendered'."

This Court did not pass upon the question of whether the adjustment in interest rates paid by Missouri Pacific should be reflected in the rates charged by Missouri Pacific to New Orleans. Indeed, this Court could not have passed upon this question for the adjustment in the interest rate paid by Missouri Pacific to the R. F. C. was authorized by the District Court by order dated May 29, 1946, and the corresponding adjustment on the bank loans was authorized

by order dated June 21, 1946, while the litigation affecting the validity of the claim by Missouri Pacific against New Orleans was decided by the District Court in the *Comstock* case by opinion dated December 21, 1945. Inasmuch as the District Court record had been closed and a decision rendered thereon prior to the adjustment in rates paid by Missouri Pacific to R. F. C. and the banks, it is apparent that that issue was not, and could not have been, established in the *Comstock* case.

This Court has held that equity will not permit a majority stockholder to do business with a corporation to the detriment of the corporation, because of the fiduciary nature of its responsibilities. It is clear that a parent corporation cannot profit to the detriment of the minority stockholders of the subsidiary, nor to the detriment of the true beneficial owners of the majority stock of the subsidiary. *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307.

Petitioners offered to prove that Missouri Pacific based the interest rates on its loans to New Orleans on the cost of money to it, and that the effect of the retroactive reduction of interest on its loans was that Missouri Pacific borrowed money at 4% and reloaned it to New Orleans at 5½% and 6% profiting on the transactions in the sum of $1,369,272 to the detriment of New Orleans.

The determination of the question of whether the interest charged by Missouri Pacific to New Orleans was inequitable and excessive in view of the reduction in interest rates paid by Missouri Pacific is essential to the determination of fair and equitable treatment for the holders of Secured Serial bonds and for New Orleans stockholders. The finding of the court below that the decision of this Court in the *Comstock* case is determinative of the fairness of the

rate of interest charged New Orleans by Missouri Pacific, when the circumstances affecting the question of fairness did not arise until six months after the decision in that case, is prejudicial to the rights of Secured Serial bondholders and is contrary to and in direct conflict with decisions of this Court.

II. In the alternative, if the decision below is not in conflict with applicable decisions of this Court, it presents an important question of Federal Law which has not been, but should be, settled by this Court.

For the reasons already set forth, it is submitted that the decisions of this Court in the *Consolidated Rock Products* case and in the *Milwaukee* case require a valuation based upon earning capacity, rather than upon physical assets, regardless of whether the physical valuation is higher, or lower, than the earnings value. However, if this interpretation be considered erroneous, on the ground that the principle set forth in those cases applies only where the physical value exceeds the earnings value, the instant case presents an important question of Federal law which has not been, but should be, settled by this Court.

Both the Commission and the courts below concluded that a valuation based upon earnings may properly be reduced to the smaller amount equivalent to the smaller physical values found by the Commission. We submit that Section 77(e) contains no warrant for such a conclusion. The statute states that "only such effect shall be given to the present cost of reproduction new and less depreciation * * * as may be required under the law of the land, in light of its earning power and all other relevant facts". As this Court said in the *Milwaukee* case (318 U. S.

at 541), values other than those based on earning power are "not deemed relevant under Section 77 * * * except as they may directly bear on earning capacity".

The effect of the decision below is to authorize an entirely different principle, namely, use of earnings value, or physical value, whichever is the lower.

This is the first time, so far as we are aware, of the attempted application of any such doctrine in valuation processes for reorganization purposes. Because of the importance of this question in all future cases, we submit that it presents a substantial and important question of Federal law, which should be settled by this Court.

WHEREFORE, your petitioners respectfully pray that a writ of certiorari may be issued out of and under the seal of this Court, directed to the United States Court of Appeals for the Eighth Circuit, commanding that court to certify and send to this Court, on a day certain to be therein named, a full and complete transcript of the record and of all proceedings in the case numbered and entitled on its docket, "No. 14268, The Protective Committee for the Holders of Missouri Pacific Railroad Company 5¼% Secured Serial Gold Bonds, of which De Lancey C. Smith is Chairman, *et al.*, Appellants, *vs.* Group of Institutional Investors Holding First and Refunding Mortgage 5% Bonds of Missouri Pacific Railroad Company, *et al.*, Appellees", to the end that said cause may be reviewed and determined by this Court, that the judgment of said Court of Appeals entered August 14, 1951, be reversed and that your petitioners be

granted such other and further relief as to this Honorable Court may seem just and proper.

Dated: November 7, 1951.

Respectfully submitted,

LEMUEL SKIDMORE,
CARL H. MCCLURE III,
165 Broadway,
New York, N. Y.,
Attorneys for Protective Committee.

DE LANCEY C. SMITH,
351 California Street,
San Francisco, California,
Attorney for De Lancey C. Smith,
Avery Brundage, *et al.*

FRED N. OLIVER,
WILLARD P. SCOTT,
110 East 42nd Street,
New York, N. Y.,
Attorneys for James B. Morris.

FOREST P. TRALLES,
CARROLL C. GILPIN,
818 Olive Street,
St. Louis, Missouri,
Of Counsel for Petitioners.

[APPENDIX FOLLOWS]

APPENDIX.

The pertinent provisions of Section 77 of the Bankruptcy Act are as follows (11 U. S. C. A. §205):

"(e) Upon the certification of a plan by the Commission to the court, the court shall give due notice to all parties in interest of the time within which such parties may file with the court their objections to such plan, and such parties shall file, within such time as may be fixed in said notice, detailed and specific objections in writing to the plan and their claims for equitable treatment. The judge shall, after notice in such manner as he may determine to the debtor, its trustee or trustees, stockholders, creditors, and the Commission, hear all parties in interest in support of, and in opposition to, such objections to the plan and such claims for equitable treatment. After such hearing and without any hearing if no objections are filed, the judge shall approve the plan if satisfied that: (1) It complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; (2) the approximate amounts to be paid by the debtor, or by any corporation or corporations acquiring the debtor's assets, for expenses and fees incident to the reorganization, have been fully disclosed so far as they can be ascertained at the date of such hearing, are reasonable, are within such maximum limits as are fixed by the Commission, and are within such maximum limits to be subject to the approval of the judge; (3) the plan provides for the payment of all costs of administration and all other allowances made or to be made by the judge, except that allowances provided for in subsection (c), paragraph (12) of this section, may be paid in securities provided for in the plan if those entitled thereto will accept such payment, and the judge is hereby given power to approve the same.

If the judge shall not approve the plan, he shall file an opinion, stating his conclusions and the reason therefor, and he shall enter an order in which he may either dismiss the proceedings, or in his discretion and on motion of any party in interest refer the proceedings back to the Commission for further action, in which event he shall transmit to the Commission a copy of any evidence received. If the proceedings are referred back to the Commission, it shall proceed to a reconsideration of the proceedings under the provisions of subsection (d) hereof. If the judge shall approve the plan, he shall file an opinion, stating his conclusions and the reasons therefor, and enter an order to that effect, and shall send a certified copy of such opinion and order to the Commission. The plan shall then be submitted by the Commission to the creditors of each class whose claims have been filed and allowed in accordance with the requirements of subsection (c) hereof, and to the stockholders of each class, and/or to the committees or other representatives thereof, for acceptance or rejection, within such time as the Commission shall specify, together with the report or reports of the Commission thereon or such a summarization thereof as the Commission may approve, and the opinion and order of the judge: *Provided,* That submission to any class of stockholders shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, (a) that at the time of the finding the corporation is insolvent, or that at the time of the finding the equity of such class of stockholders has no value, or that the plan provides for the payment in cash to such class of stockholders of an amount not less than the value of their equity, if any, or (b) that the interests of such class of stockholders will not be adversely and materially affected by the plan, or (c) that the debtor has pursuant to authorized corporate action accepted the plan and its stockholders are bound by such acceptance: *Provided further,* That submission to any class of creditors shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, that the interests of such class of creditors will not be

adversely and materially affected by the plan, or that at the time of the finding the interests of such class of creditors have no value, or that the plan provides for the payment in cash to such class of creditors of an amount not less than the value of their interests. For the purpose of this section the acceptance or rejection by any creditor or stockholder shall be in writing, executed by him or by his duly authorized attorney, committee, or representative. If the United States of America, or any agency thereof, or any corporation (other than the Reconstruction Finance Corporation) the majority of the stock of which is owned by the United States of America, is a creditor or stockholder, the interests or claims thereof shall be deemed to be affected by the plan, and the President of the United States or any officer or agency he may designate, is hereby authorized to act in respect of the interests or claims of the United States or of such agency or other corporation. The expense of such submission shall be certified by the Commission and shall be borne by the debtor's estate. The Commission shall certify to the judge the results of such submission.

Upon receipt of such certification, the judge shall confirm the plan if satisfied that it has been accepted by or on behalf of creditors of each class to which submission is required under this subsection holding more than two-thirds in amount of the total of the allowed claims of such class which have been reported in said submission as voting on said plan, and by or on behalf of stockholders of each class to which submission is required under this subsection holding more than two-thirds of the stock of such class which has been reported in said submission as voting on said plan; and that such acceptances have not been made or procured by any means forbidden by law: *Provided,* That, if the plan has not been so accepted by the creditors and stockholders, the judge may nevertheless confirm the plan if he is satisfied and finds, after hearing, that it makes adequate provision for fair and equitable treatment for the interests or claims of those rejecting it; that such rejection is not reasonably justified in the light of the

respective rights and interests of those rejecting it and all the relevant facts; and that the plan conforms to the requirements of clauses (1) to (3), inclusive, of the first paragraph of this subsection (e): *Provided further,* That if, in any reorganization proceeding under this section, the United States is a creditor on claims for taxes or customs duties (whether or not the United States has any other interest in, or claim against, the debtor, as creditor or stockholder), no plan which does not provide for the payment thereof shall be confirmed by the judge except upon the acceptance certified to the court, of a lesser amount by the President of the United States or the officer or agency designated by him pursuant to the provisions of the preceding paragraph hereof: *Provided further,* That if the President of the United States or such officer or agency shall fail to accept or reject such lesser amount for more than ninety days after receipt of written notice so to do from the court, accompanied by a certified copy of the plan, the consent of the United States insofar as its claims for taxes or customs duties are concerned shall be conclusively presumed. If the judge shall confirm the plan, he shall enter an order and file an opinion with a statement of his conclusions and his reasons therefor. If the judge shall not confirm the plan, he shall file an opinion, with a statement of his conclusions and his reasons therefor, and enter an order in which he shall either dismiss the proceedings, or, in his discretion and on the motion of any party in interest, refer the case back to the Commission for further proceedings, including the consideration of modifications of the plan or the proposal of new plans. In the event of such a reference back to the Commission, the proceedings with respect to any modified or new plan shall be governed by the provisions of this section in like manner as in an original proceeding hereunder.

If it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis

which will give due consideration to the earning power of the property, past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts."

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IN THE

Supreme Court of the United States

OCTOBER TERM 1951

No. 415

JAMES B. MORRIS, THE PROTECTIVE COMMITTEE FOR THE HOLDERS OF MISSOURI PACIFIC RAILROAD COMPANY 5¼% SECURED SERIAL GOLD BONDS, DE LANCEY C. SMITH, AVERY BRUNDAGE, *ET AL.*,
Petitioners,

v.

GROUP OF INSTITUTIONAL INVESTORS, BONDHOLDERS PROTECTIVE COMMITTEE, NEW ORLEANS, TEXAS & MEXICO RAILWAY COMPANY FIRST MORTGAGE, EDMUND WRIGHT, *ET AL.*, PROTECTIVE COMMITTEE FOR HOLDERS OF GENERAL MORTGAGE BONDS, MANUFACTURERS TRUST COMPANY, AS TRUSTEE, BANKERS TRUST COMPANY, AS TRUSTEE,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR RESPONDENT MANUFACTURERS TRUST COMPANY, AS CORPORATE TRUSTEE UNDER THE FIRST AND REFUNDING MORTGAGE OF MISSOURI PACIFIC RAILROAD COMPANY, IN OPPOSITION

LEONARD P. MOORE,
CLAIR B. HUGHES,
ALAN S. KULLER,
Attorneys for Manufacturers Trust Company, as Corporate Trustee under the First and Refunding Mortgage of Missouri Pacific Railroad Company.

CHADBOURNE, PARKE, WHITESIDE,
WOLFF & BROPHY,
25 Broadway,
New York 4, N. Y.,
Of Counsel.

Dated: New York, N. Y.
December 6, 1951.

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Record references in this brief are as follows:

C. R. = Transcript of proceedings in Cause No. 14,256 and Causes Nos. 14,264-14,274 in the Court of Appeals for the 8th Circuit.

R = The printed record filed in said United States Court of Appeals in Causes Nos. 14,264-14,274.

D. R. = The Fourth and Fifth Supplemental Report and Order of the Interstate Commerce Commission approving the plan of reorganization of Missouri Pacific Railroad Company and affiliated debtors.

IN THE

Supreme Court of the United States

OCTOBER TERM 1951

No. 415

JAMES B. MORRIS, THE PROTECTIVE COMMITTEE FOR THE HOLDERS OF MISSOURI PACIFIC RAILROAD COMPANY 5¼% SECURED SERIAL GOLD BONDS, DE LANCEY C. SMITH, AVERY BRUNDAGE, *et al.*,

Petitioners,

v.

GROUP OF INSTITUTIONAL INVESTORS, BONDHOLDERS PROTECTIVE COMMITTEE, NEW ORLEANS, TEXAS & MEXICO RAILWAY COMPANY FIRST MORTGAGE, EDMUND WRIGHT, *et al.*, PROTECTIVE COMMITTEE FOR HOLDERS OF GENERAL MORTGAGE BONDS, MANUFACTURERS TRUST COMPANY, AS TRUSTEE, BANKERS TRUST COMPANY, AS TRUSTEE,

Respondents

BRIEF FOR RESPONDENT MANUFACTURERS TRUST COMPANY, AS CORPORATE TRUSTEE UNDER THE FIRST AND REFUNDING MORTGAGE OF MISSOURI PACIFIC RAILROAD COMPANY, IN OPPOSITION

Opinions Below

The opinion of the District Court (R. 915-945)* is reported at 93 F. Supp. 832 (E. D. Mo., 1950). The opinion of the Court of Appeals for the Eighth Circuit (C. R. 14-

*See footnote page ii, *supra*.

36) is reported at 191 F. 2d 265 (8th Cir., 1951). The Fourth and Fifth Supplemental Reports of the Interstate Commerce Commission (D. R. 28469, 28640) are reported at 275 I. C. C. 59, 203 (1949).

Jurisdiction

The jurisdiction of this Court is invoked under Title 28, United States Code, Judiciary and Judicial Procedure, Section 1254.

Questions Presented

1. Whether the holders of certain junior interests in bankrupt railroad companies have been accorded a fair and equitable position in the plan of reorganization as required by Section 77 of the Bankruptcy Act, 11 U. S. C., Sec. 205.

2. Whether a subsidiary corporation is automatically entitled to a reduction in interest on a debt still owing to its parent solely because the parent corporation, by making an immediate cash payment, was able to make a compromise settlement with certain of its own creditors on loans obtained by the parent.

Statement

The present plan of reorganization is, in effect, the third plan to be approved by the Interstate Commerce Commission in the eighteen years that the Missouri Pacific system has been in reorganization under Section 77 of the Bankruptcy Act.

On January 10, 1940, the Interstate Commerce Commission approved a plan of reorganization which upon petitions for modification was somewhat changed in a supplemental order dated April 9, 1940 (239 I. C. C. 7; 240 I. C. C. 15). After hearings, the District Court for the Eastern Division of the Eastern Judicial District of Missouri, approved the plan on July 12, 1941 (39 F. Supp. 436).

Appeals were taken to the United States Circuit Court of Appeals for the Eighth Circuit. On May 8, 1943, without deciding the case on the merits, that Court referred the plan back to the District Court to determine whether "in view of the changed conditions and the decisions of the Supreme Court under date of March 15, 1943, in the cases involving the reorganization of the Western Pacific and Chicago, Milwaukee, St. Paul & Pacific Railroad Companies," the plan should be referred back to the Interstate Commerce Commission for further consideration (1946 R. 48). On July 29, 1943, the District Court referred the plan back to the Commission (1946 R. 126-27).

Further hearings were held in the fall of 1943 and a plan known as the Compromise Plan was approved by the Commission on July 4, 1944 (1946 R. 646; 257 I. C. C. 479). This plan was further modified and approved by the Commission on October 9, 1944 (1946 R. 783; 257 I. C. C. 745). On January 22, 1946 the District Court approved the Compromise Plan (1946 R. 1119, 1123; 64 F. Supp. 64), but after appeals were taken, the Court of Appeals, in September, 1947, again without deciding the case on the merits, referred it back to the District Court, this time with directions to return the plan to the Commission "for further consideration, investigation and recommendation" (*Wright* v. *Group of Institutional Investors,* etc., 163 F. 2d 1022).

After a substantial amount of additional proof was received by the Commission, at hearings held in the spring of 1948, the Commission issued its Fourth Supplemental Report approving a modified plan of reorganization (D. R. 28469; 275 I. C. C. 59). Thereafter petitions for further modification and replies thereto were filed and on December 29, 1949, the Commission issued a Fifth Supplemental Report and Order which made some minor modifications in the modified plan of reorganization (D. R. 28640, 28687; 275 I. C. C. 203). This plan was approved by the District Court on July 29, 1950 (R. 915; 93 F. Supp. 832). The Court of Appeals for the Eighth Circuit affirmed the judgment of the District Court (C. R. 14; 191 F. 2d 265).

The three major units of the Missouri Pacific system are the Missouri Pacific Railroad Company, the New Orleans, Texas & Mexico Railway Company and the International Great Northern Railway Company.

The Missouri Pacific Railroad Company owns about 95% of the capital stock of the New Orleans, Texas and Mexico Railway Company (hereinafter called NOTM), and the latter owns all of the capital stock of the International Great Northern Railway Company.

Petitioners are: (1) holders or representatives of holders of 5¼% secured serial gold bonds issued by the Missouri Pacific Railroad Company and secured by the pledge of about 82% of the capital stock of the NOTM; (2) owners of some of the publicly held common stock of the NOTM.

As the plan of reorganization provides for consolidation of the system companies into one new corporation, the different groups of bondholders, and stockholders who participate in the plan, will receive for their various claims against each of the existing companies, securities of the reorganized corporation.

Each 5¼% secured serial bond of the Missouri Pacific Railroad Company is secured by 10 shares of NOTM common stock. In exchange for surrendering his rights in that security, and for the balance of his claim, each secured serial bondholder receives, under the plan of reorganization, $1,500 in general mortgage income 4½% bonds, $291 in preferred stock and $250 in Class A common stock. The Interstate Commerce Commission and the Courts below found that this allocation gave the secured serial bondholders full compensatory treatment for their claims of $1,791.88 per bond (D. R. 28586-588).

In exchange for each share of NOTM common stock, each stockholder receives, under the plan of reorganization, $150 in general mortgage income 4½% bonds and $25 in Class A common stock of the new corporation. The Commission and the Courts below found that this allocation gave the NOTM stockholders full compensatory treatment.

Argument

Petitioners have sought to create a question of law for this Court to decide, by seizing upon the dollar amount at which the Commission capitalized the NOTM considered as a separate company. But, the fact is that the Commission's determination of the NOTM's maximum permissible capitalization did not limit the amount or quality of securities allocated to petitioners for their old securities, and had no effect in determining the amount of compensation due petitioners for surrender of their interest in their old securities. As pointed out by the Court of Appeals (C. R. 28-29; 191 F. 2d at p. 273):

> ". . . the Commission did not fail to give full consideration to the earning power of the New Orleans

> as such earning power was found by it. When it came to provide for the compensation to be awarded in respect of the New Orleans stock it made its allocations on the basis of the full value of the stock. No one interested in that stock was in any wise prejudiced by the permissible dollar valuation of the New Orleans Company for the System capitalization. The Commission undertook to fully compensate those interested in that stock in the allocations it made in respect thereof."

Petitioners' real complaint is that they believe that the facts entitle them to more compensation. But the Commission, the District Court and the Court of Appeals all carefully considered the facts and found that they did not warrant any additional compensation. No reason, therefore, exists for this Court to examine these questions of fact further.

Petitioners also ask this Court to consider the refusal of the Commission (D. R. 28618), the District Court (R. 1033; 93 F. Supp. at p. 856), and the Court of Appeals (C. R. 34; 191 F. 2d at p. 275), to scale down, by about $1,300,000, the debt of approximately $20,000,000 of the NOTM to the Missouri Pacific Railroad Company, by applying lower rates of interest than those called for in the promissory notes and the accounts stated. The Commission and the Courts below held that the agreed rates of interest at the time the debts were incurred were reasonable and are binding on the New Orleans. The decision was correct and presents no important question of federal law which this Court should review.

I

PETITIONERS HAVE RECEIVED FAIR AND EQUITABLE TREATMENT UNDER THE PLAN.

In *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Company,* 318 U. S. 523, 565-66 (1943), this Court said, "It is sufficient that each security holder in the order of his priority receives from that which is available for the satisfaction of his claim the equitable equivalent of the rights surrendered." Petitioners surrender rights in the common stock of NOTM. The Commission valued this stock at $150 per share, an amount well in excess of its market quotation (R. 935; 93 F. Supp. at p. 849). Not only did the Commission place this high value on the NOTM stock but it awarded, in recognition of that value, a higher grade of securities of the new corporation—general mortgage income bonds. Nor did the Commission stop there, for it found that the $150 valuation it placed on the common stock "will not, however, if represented by the issue of new general mortgage bonds of limited return, fully compensate the secured serial bondholders and the public owners of the New Orleans stock, who must receive the new System securities, for the loss of their rights under separate capitalization of the New Orleans to participate in the possible continuance in the high level of that company's earnings in the future" (D. R. 28585). Therefore, the Commission also allocated common stock of the new company to the secured serial bondholders and NOTM stockholders to afford them an opportunity "to participate in whatever prosperity the new system company may enjoy in the future" (D. R. 28585). In addition, the secured serial bond-

holders receive, for the unsecured portion of their claim, an allocation of preferred stock which constitutes "more favorable treatment than accorded other unsecured creditors of the Missouri Pacific" (D. R. 28586).

The Commission concluded that, "we have accorded to them the full equitable equivalent of the value of their stock and any further allocation will be unjustly at the expense of the creditors of the other debtors" (D. R. 28663).

The District Court found that "the Commission's allocation has given the secured serials full compensatory treatment" (R. 935; 93 F. Supp. at p. 850).

In affirming, the Court of Appeals pointed out (C. R. 19; 191 F. 2d at pages 268-69):

> "The holders of the Serial bonds secured by the stock and the owners of the unpledged stock have been accorded a position in the Plan which the Commission thought was far superior to that of any other junior interest."

The petitioners received "full compensatory treatment . . . in the informed judgment of the Commission and the District Court on consideration of all relevant facts" (*Milwaukee* case, 318 U. S. at p. 566). The Commission and the Courts below acted in full conformity with the requirements of section 77 and the decisions of this Court in determining that petitioners had received fair and equitable treatment under the Plan.

II

THE METHOD OF ALLOCATION DOES NOT CONFLICT WITH THE DECISIONS OF THIS COURT.

Petitioners assert a conflict between this case and the decision of this Court in *Consolidated Rock Products Co.*

v. *DuBois*, 312 U. S. 510 (1940) and *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Co.*, 318 U. S. 523 (1943). The only basis for the alleged conflict is "that physical values have been effectively relied upon in this case to limit the value that would otherwise have resulted from the application of the normal earnings tests" (Petition for Writ of Certiorari, p. 13). But as already pointed out, the secured serial bondholders and the New Orleans stockholders received full compensatory treatment under the plan and no one interested in that stock was in any wise prejudiced by the permissible dollar capitalization of the NOTM.

The Commission did find that "it would not be in the public interest to declare a capitalization for New Orleans at a dollar amount in excess of both physical value and the investment in transportation properties as shown by the balance sheet of the New Orleans" (C. R. 28; 191 F. 2d at p. 273). But, "The system capitalization and allocation of system securities herein approved by us reflects any additional earnings power of the New Orleans for which the system should compensate the New Orleans security holders" (I. C. C. Fourth Supplemental Report, D. R. 28561-562). Petitioners' error is in failing to recognize, as did the Commission and Courts below, that adding to the dollar amount of capitalization of the NOTM would not give them any greater amount of new securities of equal quality with those allocated to them under the plan. Thus there is no basis to petitioners' complaint that physical values were relied upon to limit the value of their securities, and therefore the alleged conflict of decisions evaporates from the case.

III

THE DECISIONS BELOW REFUSING TO SCALE DOWN THE NEW ORLEANS DEBT WERE CORRECT.

Prior to 1933 (when both companies went bankrupt), the Missouri Pacific Railroad Company borrowed money at 6% from the Reconstruction Finance Corporation and certain banks, and at approximately the same times made advances to the NOTM at the same rates. In 1946 the Missouri Pacific Railroad Company, by making an immediate payment in cash in lieu of reorganization securities, effected a compromise of the amounts it had borrowed at 6%, the interest on the principal amounts being reduced to 4% retroactively to 1933 (R. 1035; 93 F. Supp. at 856). Petitioners unsuccessfully maintained before the Commission and Courts below that the interest rate on the advances from the Missouri Pacific to the NOTM should be retroactively reduced back to 1933 because of the compromise settlements between the Missouri Pacific Railroad Company and its creditors. The Commission in its Fourth Supplemental Report gave detailed consideration to the petitioners' argument and rejected it for the following reasons:

1. "There is no showing or allegation, or offer of proof by petitioner as to the interest rate at which the New Orleans could have effected its own financing during the periods in question" (D. R. 28625).

2. "The decrease in interest rate from 6 to 4 percent was agreed to by these creditors as part of immediate compromise settlements of their entire claims, without their waiting for satisfaction of the claims through the process of reorganization. No such situation prevails

with respect to the advances by Missouri Pacific to the New Orleans" (D. R. 28627).

3. The "funds used by Missouri Pacific in paying the claims . . . were earned by its own lines of railroad and not by those of the New Orleans" (D. R. 28627).

Far from relying on the decision of this Court in *Comstock* v. *Group of Institutional Investors,* 335 U. S. 211 (1948), in rejecting petitioners' claim, the Commission said (D. R. 28628):

> "In view of these findings it is unnecessary for us to decide . . . whether the total amount of the claim of Missouri Pacific against the New Orleans was finally determined by the orders of the Courts in the *Comstock* case . . ."

The District Court did hold, and properly so, that the *Comstock* case established the validity of the debt and the fairness of the rate of interest at the time the advances were made (R. 1035-36; 93 F. Supp. at p. 857). But the District Court did not perform the extraordinary feat attributed to it by the petitioners of holding that the *Comstock* case determined the effect of the 1946 compromise which was made six months after the decision in that case (Petition for Writ of Certiorari, pp. 16-17). In approving the action of the Commission the District Court took cognizance of the statement in *Ewen* v. *Peoria & Eastern Railway Co.,* 78 F. Supp. 312, 316 (S. D. N. Y., 1948), cert. denied 336 U. S. 919, that "the intercompany transactions must be fair and the test is 'whether the proposition sub-

mitted would have commended itself to an independent corporation'." The Commission and Courts below found that, on the facts, there was no unfairness in refusing to give the NOTM whatever benefit resulted to the Missouri Pacific Railroad Company from making a cash settlement of some of its own debt. There is no reason for this Court to review or disturb that finding.

CONCLUSION

The petition should be denied.

Respectfully submitted,

LEONARD P. MOORE,
CLAIR B. HUGHES,
ALAN S. KULLER,
Attorneys for Manufacturers Trust Company, as Corporate Trustee under the First and Refunding Mortgage of Missouri Pacific Railroad Company.

CHADBOURNE, PARKE, WHITESIDE,
WOLFF & BROPHY,
25 Broadway,
New York 4, N. Y.,
Of Counsel.

Dated: New York, N. Y.
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Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE EIGHTH CIRCUIT

CHARLES W. MCCONAUGHY,
MORRIS D. CRAWFORD, JR.,
14 Wall Street,
New York 5, N. Y.,
Attorneys for Group of Institutional Investors Holding First and Refunding Mortgage 5% Bonds of Missouri Pacific Railroad Company.

CADWALADER, WICKERSHAM & TAFT,
Of Counsel.

SANFORD H. E. FREUND,
20 Exchange Place,
New York 5, N. Y.,
Attorney for Bondholders Protective Committee, Missouri Pacific Railroad Company General Mortgage.

SHEARMAN & STERLING & WRIGHT,
Of Counsel.

WILLIAM P. PALMER,
PHILIP E. GREGG,
31 Nassau Street,
New York 5, N. Y.,
Attorneys for Bankers Trust Company, Successor Trustee under Missouri Pacific Railroad Company Twenty-Year 5½% Convertible Gold Bonds Indenture.

ROOT, BALLANTINE, HARLAN,
BUSHBY & PALMER,
Of Counsel.

Dated: December 7, 1951.

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Abbreviations Used in this Brief

Commission:	Interstate Commerce Commission.
Court of Appeals:	United States Court of Appeals for the Eighth Circuit.
C.R.:	Transcript of Proceedings in Cause No. 14256 and Causes Nos. 14264-14274 in the United States Court of Appeals for the Eighth Circuit. (One volume)
District Court:	District Court of the United States, Eastern Judicial District of Missouri, Eastern Division.
D.R.:	Fourth Supplemental Report, dated August 2, 1949, and Fifth Supplemental Report and Order, both dated December 29, 1949, of the Commission approving the Plan of Reorganization of Missouri Pacific Railroad Company and affiliated debtors. (One volume)
Inter-company Claim:	The claim of Missouri Pacific against New Orleans for advances to the latter, which, together with interest, amounted to $18,091,681 on January 1, 1948.
Missouri Pacific:	Missouri Pacific Railroad Company, the principal debtor in these proceedings.
New Orleans:	New Orleans, Texas & Mexico Railway Company (a subsidiary of Missouri Pacific) and its fourteen subsidiaries, all debtors in these proceedings.

Plan:	The Plan of Reorganization approved by the Interstate Commerce Commission in its Supplemental Report and Order dated December 29, 1949 (D.R. 28640-28760).
R.:	The printed record on appeal filed in the United States Court of Appeals for the Eighth Circuit in Causes Nos. 14264-14274. (Two volumes)
1941 R.:	The record on appeal filed in the United States Court of Appeals for the Eighth Circuit in appeals numbered 12130-12136, inclusive. (Four volumes)
1946 R.:	The record on appeal filed in the United States Court of Appeals for the Eighth Circuit in appeals numbered 13371 to 13373, both inclusive. (Three volumes)
R.F.C.:	Reconstruction Finance Corporation.
Section 20a:	Section 20a of the Interstate Commerce Act (49 U. S. C. A. 20a).
Section 77:	Section 77 of the Bankruptcy Act (11 U. S. C. A. §205).
Secured Serial Bonds:	Missouri Pacific Railroad Company 5¼% Secured Serial Bonds, which are collateral obligations of Missouri Pacific secured by the pledge of approximately 81.9% of the capital stock of New Orleans.

IN THE

Supreme Court of the United States

OCTOBER TERM 1951

No. 415

JAMES B. MORRIS, THE PROTECTIVE COMMITTEE FOR THE HOLDERS OF MISSOURI PACIFIC RAILROAD COMPANY 5¼% SECURED SERIAL GOLD BONDS, DE LANCEY C. SMITH, AVERY BRUNDAGE, *et al.*,

Petitioners,

v.

GROUP OF INSTITUTIONAL INVESTORS, BONDHOLDERS PROTECTIVE COMMITTEE, NEW ORLEANS, TEXAS & MEXICO RAILWAY COMPANY FIRST MORTGAGE, EDMUND WRIGHT, *et al.*, PROTECTIVE COMMITTEE FOR HOLDERS OF GENERAL MORTGAGE BONDS, MANUFACTURERS TRUST COMPANY, AS TRUSTEE, BANKERS TRUST COMPANY, AS TRUSTEE,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE EIGHTH CIRCUIT

This brief is filed in opposition to the petition of James B. Morris, *et al.*, for a writ of certiorari to review the judgment of the Court of Appeals for the Eighth Circuit affirming the order of the United States District Court for the Eastern Judicial District of Missouri, Eastern Division, approving the Plan.

Opinions Below

Court of Appeals—*State of Texas* v. *Group of Institutional Investors Holding First and Refunding Mortgage 5% Bonds of Missouri Pacific Railroad Company, et al.*, 191 F. 2d 265 (8th Cir. 1951); (C. R. 14-36).

District Court—*In re Missouri Pacific R. Co.*, 93 F. Supp. 832 (E. D. Mo. 1950); (R. 915-945).

Jurisdiction

The jurisdiction of this Court is invoked under Title 28, United States Code, Judiciary and Judicial Procedure, Section 1254.

POINT I

The decision below is not in conflict with applicable decisions of this Court.

The petition presents two questions which this Court is asked to decide (Petition, p. 7).

The first question concerns petitioners' contention that the Commission arbitrarily limited the valuation of the New Orleans by its physical factors in disregard of its earnings. The error of this contention, which has been clearly demonstrated by the Commission (D. R. 28655-663) and the Court below (C. R. 27-29, 30-32), results from a basic misapprehension of the meaning of value for reorganization purposes.

Petitioners assume that the New Orleans capitalization of $83,700,000, standing alone, is an expression of value for reorganization purposes. They then seek to show that such capitalization is inadequate by emphasizing the higher

capitalizations obtainable by capitalizing earnings for various periods at various rates* (Petition, pp. 3, 12).

Value for purposes of reorganization cannot be expressed in terms of dollars alone. To do so would only create an illusion of certainty where none exists. *Group of Institutional Investors* v. *Chicago, Milwaukee, St. P. & P. R. Co.*, 318 U. S. 523, 565 (1943). It is utterly futile to argue that $83,700,000 is too low a capitalization for the New Orleans (Petitioners' Brief, p. 13). The Commission has demonstrated that the dollar amount of capitalization is meaningless without reference to the quality of the new securities which are to be issued under the Plan (D. R. 28659-61).

Nor is valuation the simple mathematical process which is suggested by the arguments of the petitioners. They cite no authoritative decision which requires that reorganization value be determined by the capitalization of earnings in accordance with some mathematical formula. The courts have recognized that there is no magic formula for determining value. Essentially the process involves the exercise of judgment. *Group of Institutional Investors* v. *Chicago, Milwaukee, St. P. & P. R. Co.*, 318 U. S. 523, 565 (1943). In recognition of this fact Congress has charged the Commission with the duty of making valuations. Its long experience qualifies it as an expert in such matters.

Section 77 imposes two principal requirements with respect to value and capitalization. The first of these has to do with private rights. The second pertains to the public interest. To protect private rights the new capitalization fixed by the Commission must permit the satisfaction

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* The Commission considered the results of such computations (D. R. 28558-60), but declined to give conclusive weight to any single test (D. R. 28560-61).

of all claims and interests to the full extent of their value measured by earning capacity. The Commission is also required to make its capitalization conform with the requirements of the public interest. Thus, the new capitalization must balance these two interests. *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448 (1943), *Group of Institutional Investors* v. *Chicago, Milwaukee, St. P. & P. R. Co.*, 318 U. S. 523 (1943).

The Commission gave careful consideration to the earning power of the New Orleans (D. R. 28526-47; 28549-50, 28558, 28560-62) and recognized that in determining maximum permissible capitalization "greatest weight should be given to past and prospective earnings" (D. R. 28553). It found that the securities allocated in respect of the assets of the New Orleans fully compensated the Secured Serial bondholders and the holders of common stock of the New Orleans, and fairly represented the earnings value of the New Orleans (D. R. 28561-62, 28585, 28588, 28663). The Court below and the District Court have concluded that these findings are supported by substantial evidence (C. R. 27, 30-32, 36; R. 949). The determination of whether new securities allocated under a plan are compensatory "rests in the informed judgment of the Commission and the District Court on consideration of all relevant facts". *Milwaukee* case, *supra*, at pages 565-6.

Having thus accorded full recognition to "private rights" it was proper for the Commission to consider physical values, investment in transportation property, size of plant and other factors to the extent that they affected the public interest, and to permit these factors to influence its decision as to capitalization. The cases under Section 20a of the Interstate Commerce Act and the discussions in Congress prior to the enactment of Section 20a demonstrate that there is a public interest in maintaining

a close relationship between capitalization and the value of physical assets intended for continuing productive use in the service of transportation. *Queen City Coach Co. Stock*, 271 I.C.C. 476 (1949); *Securities of Louisville and Nashville R. Co.*, 76 I.C.C. 718 (1923); 58 *Congressional Record*, 8376 *et seq.* (1919). It can hardly be contended that the "public interest" under Section 77 is different from the "public interest" under Section 20a. The provisions of Section 20a apply to reorganization proceedings under Section 77. *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448 (1943).

The dual responsibility of the Commission to satisfy private rights and to serve the public interest in proceedings under Section 77 was fully recognized by the Court below in its discussion of New Orleans capitalization (C. R. 27-28).

Thus the record demonstrates that earnings were the controlling factor in the Commission's determination of the value of the New Orleans for reorganization purposes and that physical values, although permitted to influence the Commission's determination of capitalization, did not prevent the holders of Secured Serial Bonds and New Orleans stock from receiving fully compensatory treatment. Accordingly, the first question posed by petitioners is non-existent in this proceeding, and the decision of the Commission and the Courts below with respect to New Orleans capitalization and allocations cannot be said to be in conflict with other applicable decisions of this Court.

The second question posed by the petition (p. 7) is whether this Court's decision in *Comstock* v. *Group of Institutional Investors, et al.*, 335 U. S. 211 (1948) as to the validity of the so-called "inter-company claim" of Missouri Pacific against New Orleans "can be determinative of the fairness" of the interest rate charged by Mis-

souri Pacific on that claim, since "circumstances affecting the question of fairness" arose after the District Court's decision in the *Comstock* case. The circumstance referred to was the settlement by Missouri Pacific of its indebtedness to the R.F.C. in 1946 by payment of the principal thereof in full with interest at the rate of 4% per annum from the date of commencement of bankruptcy instead of the contract rate of 6%.

Of course, we do not contend that this Court in the *Comstock* case considered whether this subsequent adjustment of interest rates should be reflected in the rates charged on the inter-company claim. Nor is it fair to state that the District Court in this proceeding has "apparently overlooked" the fact that the R.F.C. settlement antedated the District Court's order in the *Comstock* case (Petition, p. 6). The District Court in this proceeding was of the opinion that the *Comstock* case established the "fairness" of the contract rates of interest (5½% and 6%) charged on the inter-company claim, quite apart from the effect, if any, of the subsequent settlement of Missouri Pacific's indebtedness to the R.F.C. (R. 1034-36). This is supported by the record.*

The District Court discussed the question of whether there was any duty on the parent corporation (Missouri Pacific) to pass on to its subsidiary (New Orleans) the benefit of the retroactive reduction in interest rates on

* In the *Comstock* case, Comstock alleged in his Objection 19 that the inter-company claim "is invalid in all respects" (1946 R. Vol. II, 861). The District Court found that the record contained no evidence tending to show that interest at the rates charged during the period of advances "were other than the customary rates of interest usually charged for similar types of loans" (1946 R. Vol. III, 1138). That finding was assigned as error by Comstock in his appeal to this Court. The District Court's findings were affirmed by the Court of Appeals and by this Court. *Comstock* v. *Group of Institutional Investors, et al.*, 163 F. 2d 350 (8th Cir., 1947), aff'd 335 U. S. 211 (1948).

the R.F.C. loan. That discussion would have been unnecessary if the District Court had proceeded on the theory that this question was *res adjudicata* under the *Comstock* case. Recognizing the fiduciary relationship existing between parent and subsidiary, the District Court held that this relationship "requires only that the parent company fix the terms of the advances to the subsidiary fairly" (R. 1036) and found that no showing had been made that the rates of interest charged by Missouri Pacific on the inter-company claim were higher than the New Orleans could have obtained in arm's length borrowing (R. 1052). *Ewen* v. *Peoria & Eastern Railway Co.*, 78 F. Supp. 312 (1948), cert. den. 336 U. S. 919 (1949).

Even if the testimony sought to be introduced by petitioners (Petition, pp. 5-6) were sufficient to establish that the interest rates charged on the inter-company claim were in fact based on the cost of Missouri Pacific financing, it does not follow that the rate charged on the inter-company claim should be reduced to 4% because of the R.F.C. settlement. The only plausible reason why the R.F.C. and the banks agreed in 1946 to the reduction in interest is that, since the Missouri Pacific had then been in reorganization for thirteen years, it was prudent business to accept a cash settlement involving only a reduction of interest in default. The reduction in interest was a part of the consideration for receiving prompt payment in cash instead of securities at some indefinite future time. Furthermore, the cash used to purchase the R.F.C. claim was money earned by the property of the Missouri Pacific —not the New Orleans (D. R. 28627). Accordingly, in so far as the settlement of the R.F.C. claim represented a benefit to the bankrupt Missouri Pacific, it was made possible only by earnings of that debtor. To make such bene-

fit available to the New Orleans, which contributed nothing to the discharge of the claims, would be a windfall to the New Orleans and a distinct injustice to Missouri Pacific creditors.

In posing their second question, the petitioners have confused the issue of "fairness" with the alleged duty of a parent to pass on to its subsidiary savings in the cost of borrowing money. The "fairness" of the interest rate charged by Missouri Pacific on the inter-company claim must be judged in the light of circumstances at the time of the advances. The subsequent R.F.C. settlement can have no bearing on the "fairness" of an interest rate fixed thirteen years before.

POINT II

The petition presents no important question of Federal law.

Petitioners urge in the alternative that if the doctrine of the *Consolidated Rock Products* and *Milwaukee* cases that reorganization value shall be based on earning capacity applies only where physical value exceeds earnings value, the instant case presents an important question of Federal law which should be settled by this Court (Petition, pp. 17-18). Again this Court is asked to determine a non-existent question. As indicated above, physical values in this proceeding were allowed to affect capitalization only after full compensation, based on earnings, had been accorded to security holders. Physical values did not determine the amount and quality of the new securities allocated in the Plan to the petitioners.

CONCLUSION

The petition should be denied.

Respectfully submitted,

CHARLES W. McCONAUGHY,
MORRIS D. CRAWFORD, JR.,
14 Wall Street,
New York 5, N. Y.,
Attorneys for Group of Institutional Investors Holding First and Refunding Mortgage 5% Bonds of Missouri Pacific Railroad Company.

CADWALADER, WICKERSHAM & TAFT,
Of Counsel.

SANFORD H. E. FREUND,
20 Exchange Place,
New York 5, N. Y.,
Attorney for Bondholders Protective Committee, Missouri Pacific Railroad Company General Mortgage.

SHEARMAN & STERLING & WRIGHT,
Of Counsel.

WILLIAM P. PALMER,
PHILIP E. GREGG,
~~PHILIP GREGG,~~
31 Nassau Street,
New York 5, N. Y.,
Attorneys for Bankers Trust Company, Successor Trustee under Missouri Pacific Railroad Company Twenty-Year 5½% Convertible Gold Bonds Indenture.

ROOT, BALLANTINE, HARLAN,
BUSHBY & PALMER,
Of Counsel.

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